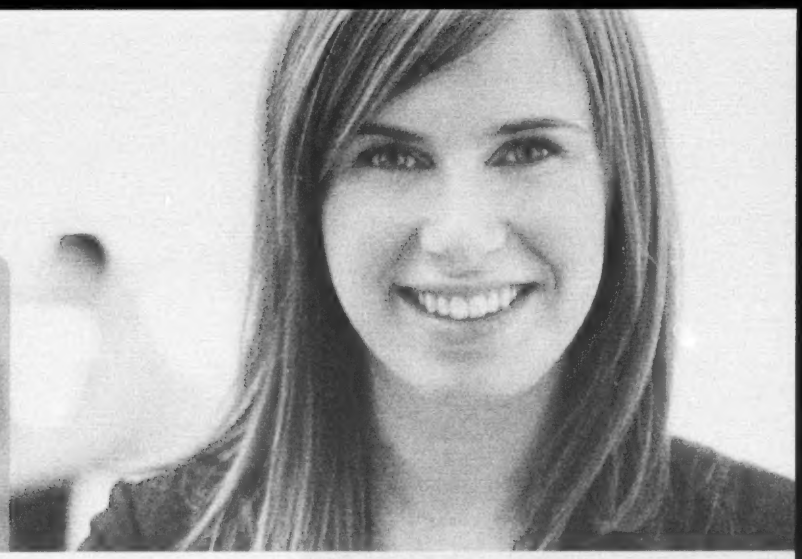
BDC
Entrepreneurs first

economic LETTER

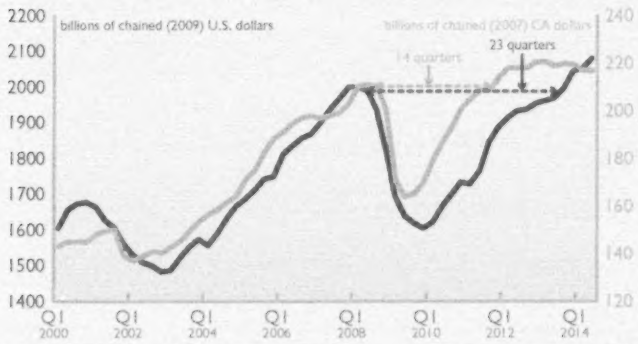
SEPTEMBER 2014



TAKING STOCK OF BUSINESS INVESTMENT IN CANADA

Non-residential investment by Canadian private enterprises has barely increased since the first quarter of 2012, even though it did rebound fairly quickly after the recession (Graph 1).

Graph 1: Non-residential investment in Canada and in the United States (2000 Q1 to 2014 Q2)



Sources: Statistics Canada and U.S. Bureau of Economic Analysis

Nevertheless, firms are in an excellent financial position: debt rates are low, and profits are on the rise. Moreover, business credit is available and affordable. So, what is going on?

The uncertainty that has clouded economic outlooks since 2012 is no doubt one of the causes of this weak investment. Naturally, business leaders need to view the future with optimism in order to invest. But we cannot say that outlooks have been very encouraging in recent years: for 2012, the outlook for real GDP growth in the United States, our main trading partner, had been just 2.2% at the beginning of the year, and just 1.9% for 2013. And, in fact, growth did not prove to be much higher than forecast during those two years (2.3% in 2012 and 2.2% in 2013), mainly due to the negative effects of fiscal austerity. The outlooks for growth in the Canadian economy were not any stronger, and growth did prove to be quite modest: 1.7% in 2012 and 2.0% in 2013. ▼

Canada
- Real GDP growth heads up
- Employment declines slightly
- The trade surplus widens
- Housing starts are up again

United States
- Real GDP rebounds as expected
- Moderate improvement in employment
- The housing market keeps firming up

Interest rates

No prospect of a key interest rate hike before 2015

Oil price

Canadian dollar

SME confidence

Credit conditions

Key indicators

BDC's Monthly Economic Letter is prepared by the Economic Analysis team from Marketing and Public Affairs and is based on a variety of public sources of economic data. The information in this letter is drawn from data released prior to September 6. Reliance on and use of this information is the reader's responsibility.

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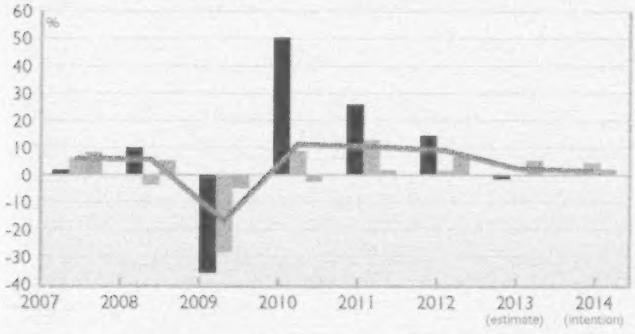
During this period, the sovereign debt crisis pushed many European countries into recession, which curbed the growth of the advanced economies. This had repercussions on developing countries, some of which also began experiencing structural problems that hindered their growth. In China, for instance, wages rose significantly. But instead of leading to an acceleration in consumption, these higher wages generated an increase in savings, due to the absence of a social safety net. In addition, this made China less competitive compared with other emerging countries, which also contributed to the slowdown in its growth. As for India, it has serious problems with public infrastructure and suffers labour shortages due to the low level of education of its population, which limits its productive capacity. The recession in Europe and the slower growth in the emerging countries helped create an unpropitious climate for investments.

At the same time, the prices of many commodities, especially metals and minerals, have declined significantly since 2012. Consequently, investment growth in Canada's mining and gas and oil extraction sector, which had been the main pillar of growth in non-residential investment since the recession, fell into negative territory in 2013 (Graph 2). Given the weight of investments in this sector (nearly 40% of the total), this contributed strongly to the slowdown in growth of private, non-residential investment as a whole.

Graph 2: Private non-residential investment, by sector
(annual change, 2007 to 2014)



Source: Statistics Canada

Canada is not alone in suffering from weakness in non-residential investment by private firms; the same holds true in the United States. As shown in Graph 1, it took 23 quarters for business investment to return to where it stood before the financial crisis in the United States, compared with just 14 quarters in Canada. On the other hand, investment has increased more sharply in the United States than in Canada since the recession. In the second quarter of 2014, it stood 4.7% higher than where it was six years ago, whereas in Canada the growth was a mere 2.8%. That said, in both cases this growth is extremely feeble.

In recent months, growth in Canadian exports to the United States has clearly accelerated. This is due to two factors: a) the stimulating effect of the loonie's 12% depreciation against the U.S. dollar between the end of 2012 and the beginning of 2014, and b) strengthening demand south of the border. The latest economic indicators suggest that economic growth will continue to firm up in the United States in the second half of 2014, and will accelerate in 2015. Once stimulated by higher exports, the Canadian economy should also get back on track. The improvement in the growth outlook should encourage Canadian firms to invest. In its most recent Monetary Policy Report, the Bank of Canada anticipates that the contribution of businesses' non-residential investment to real GDP growth will be zero this year, but will reach 0.6% in 2015.■

CANADA

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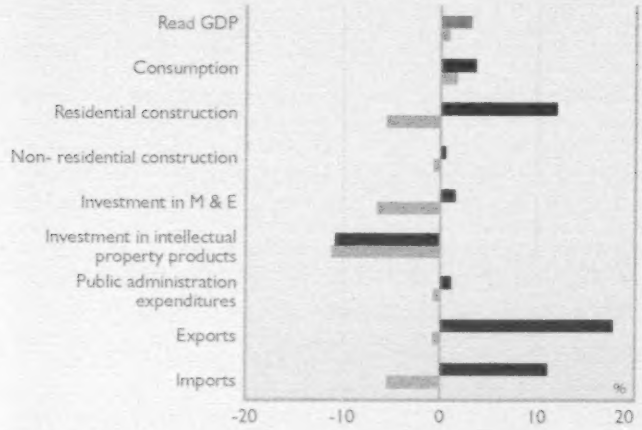
Economic growth was fairly modest during the first half of the year, but the strong surge in exports in recent months bodes well. It offers hope of improvement in business investment, which in turn should generate, in the medium to long term, growth in employment.

Real GDP growth heads up

Real GDP grew by 3.1% in the second quarter, after growth of just 0.9% in the first quarter. All the components of real GDP saw an acceleration in their pace of growth in the second quarter (Graph). Exports actually soared, recording an increase of 17.8% compared with the previous quarter. It seems that the effects of the past depreciation of the Canadian dollar against the U.S. dollar are finally beginning to materialize. Meanwhile, growth in imports was also very strong, which curbed GDP growth. Unfortunately, non-residential investment declined for the third straight quarter, due to a second significant downturn in investments in intellectual property. We can only hope that the surge in exports will trigger an increase in business investment in the next few quarters.▼

Quarterly Growth, at annual rate, of Real GDP and its main components



Source: Statistics Canada

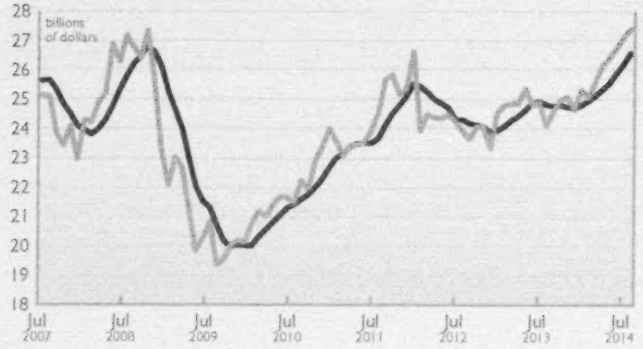
Employment declines slightly

The loss of 8,700 part-time jobs and 2,300 full-time jobs means that the job market shrank by 11,000 jobs in August. Over a 12-month horizon, employment was up by just 0.5% in August, and the growth came mainly from part-time work, which expanded by 2.0% between August 2013 and August 2014, while full-time employment expanded by just 0.1% during that period. The unemployment rate remained unchanged in August, at 7.0%. By province, Alberta posted the highest annual rate of job growth (1.7%) and Saskatchewan boasted the lowest unemployment rate (4.2%). Newfoundland and Labrador recorded the worst results, with a 3.4% decline in employment over the past 12 months and an unemployment rate of 13.5% in August.

The trade surplus widens

Exports rose by 1.4% in July while imports dipped by 0.3%; this gave a boost to the trade surplus, which climbed from $1.8 billion in June to $2.6 billion in July. The increase in exports is mainly attributable to the automotive vehicles and parts sector, whose exports advanced by 9.7% in July. If we exclude automotive vehicles and parts, exports edged up by a mere 0.1% during the month, but year over year they are up by 16%. If we also exclude energy products, which account for 25% of the total, exports were up by 1.0% in July; they have resumed a clear, upwards trend since the beginning of the year (Graph).

Exports excluding motor vehicle sector and energetical products (June 2007 to July 2014)

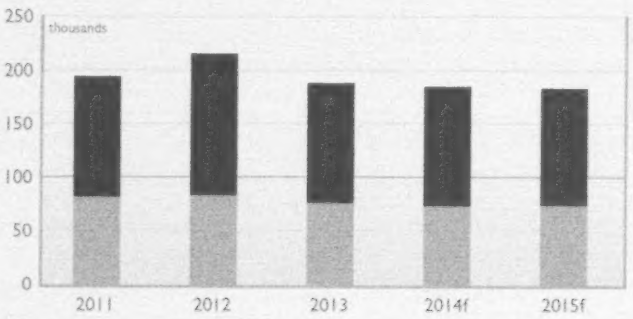


Source: Statistics Canada

Housing starts are up again

Starts of single-family homes increased by 4.7% in urban centres in July, while those of multiple-family dwellings declined by 2.0%. The housing start trend, measured by the six-month rolling average, rose from 185,952 in June to 189,784 in July. Despite this increase, the Canada Mortgage and Housing Corporation (CMHC) is still anticipating a soft landing by the housing market this year. The CMHC is forecasting that the number of housing starts will reach 184,800 in 2014 (Graph). In order for that forecast to materialize, there will have to be a deceleration in the coming months, since the average for the first seven months of the year is close to 188,000 at an annualized rate.■

Housing Starts (2011 to 2013, forecasts for 2014 et 2015)



Source: Canada Mortgage and Housing Corporation

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★ UNITED STATES

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The most recent data tell us that the U.S. economy is gradually regaining strength. The job and housing markets are continuing to gain ground. That said, even if it accelerates in the second part of the year, economic growth will remain modest this year.

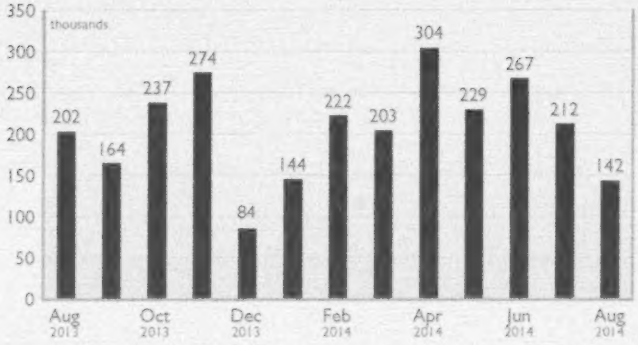
Real GDP rebounds as expected

According to the second estimate by the Bureau of Economic Analysis (BEA), real GDP grew by 4.2% in the second quarter, on the heels of a 2.1% contraction in the first quarter. This rebound in real GDP was expected, since first-quarter growth was disrupted by the negative, but temporary, effects of an extremely severe winter. Nevertheless, the first-quarter contraction will leave its mark: if growth were to reach an annualized rate of 3.0% in each of the next two quarters–which would constitute a relatively brisk pace of growth–real GDP would increase by 2.2% in 2014, which is well below the 2.8% growth that was forecast at the beginning of the year.

Moderate improvement in employment

Non-farm employment expanded by 142,000 jobs in August. This is a moderate increase compared with the average of the past six months, which is 240,000 (Graph). The unemployment rate held steady in August, at 6.1%. Employment grew by 20,000 jobs in the construction sector and was flat in the manufacturing sector. The number of people who are working part-time for economic reasons (because they have not managed to find full-time work, or because their employer has reduced their work hours) remained stable at 7.3 million. The number of discouraged workers, i.e. those who have stopped looking for work because they are convinced they will not find any, stood at 775,000 in August, around the same level where it was in August 2013.

Monthly change in employment
(August 2013 to August 2014)



Source: U.S. Bureau of Labor Statistics

The housing market keeps firming up

Things are continuing to improve in the housing market. Housing starts increased by 15.7% in July, month over month. They were up in both the single-family segment (8.3%) and the multiple-family segment (33.0%). Home sales advanced by 2.1% from June to July. The strong employment situation, the greater supply of homes, the slowdown in home price growth and the low interest rates should keep stimulating real estate sales in the months to come, according to the National Association of Realtors in the United States.■

INTEREST RATES

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No prospect of a key interest rate hike before 2015

On September 3, the Bank of Canada announced, to no-one's surprise, that it was leaving the key interest rate unchanged, at 1.0%. GDP is standing exactly at the level that the central bank had forecast in its July edition of the Monetary Policy Report. It is assuming that the upturn in exports will need to continue longer before it will generate an increase in business investment and higher employment. The Bank is claiming a neutral position regarding the future direction of the key interest rate, but it does stress that the recently observed upturn in inflation was due to temporary effects, and not to the strength of the Canadian economy. This suggests that monetary policy will remain accommodative in the coming quarters. As for the forecasters, they still do not anticipate any rate hike before 2015.■

OIL PRICE

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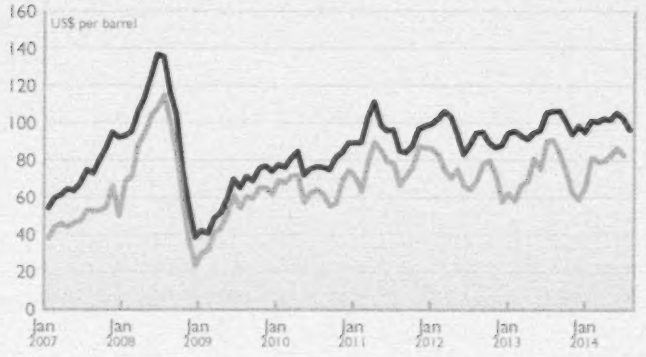
The price of crude oil falls

Despite persistent tensions in Iraq, Ukraine and Libya, the price of crude oil declined in August. The main factors underlying that drop are an abundant supply and weak demand. The supply is, in fact, amply sufficient: Iraq's oil exports have not been disrupted because, for the most part, they originate from an area that is not affected by the conflict; and Libya's oil exports have managed to get back on track. Meanwhile, global demand for oil recorded its weakest growth since 2012 in the second quarter, leading producers to revise their outlooks downwards. ■

Crude Oil Price
(January 2007 to August 2014)



Source: Global Insight and Alberta Office of Statistics and Information

CANADIAN DOLLAR

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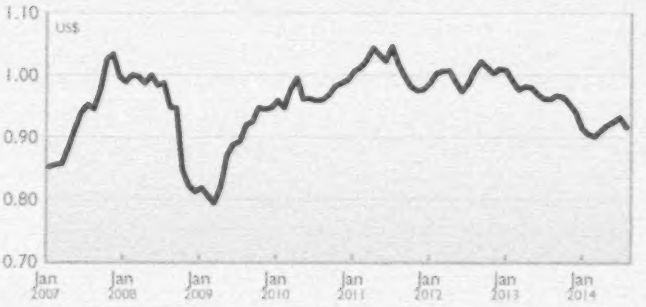
The loonie loses ground

After appreciating by 3.4% against the U.S. dollar between March and July, the loonie depreciated by 1.7% in August (Graph). The Monetary Policy Report and the most recent press releases by the Bank of Canada suggest that Canada's monetary policy will remain accommodative in the coming quarters, while the U.S. Federal Reserve is continuing its quantitative tightening and maintaining a less accommodative position. These divergences in the monetary policies of the two countries have helped to weaken the Canadian currency against the greenback. ■

Canada/United States Exchange Rate
(January 2007 to August 2014)



Source: Bank of Canada

SME CONFIDENCE

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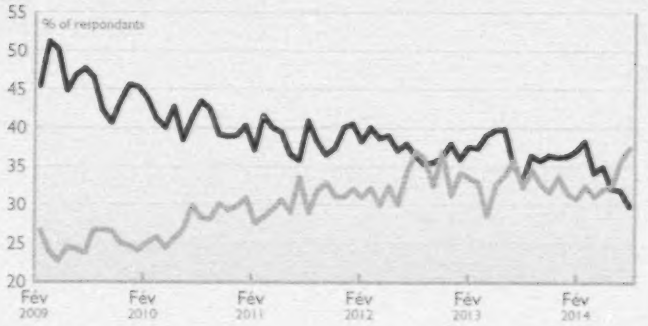
SME owners are still confident

The Canadian Federation of Independent Business's Business Barometer Index has advanced for a second straight month, from 63.2 in July to 65.5 in August. The index has been relatively stable since the beginning of the year, oscillating between a low of 64.0 in January and a high of 67.1 in May. Over a long-term horizon, many indicators point to strengthening economic activity since the recession. The percentage of respondents who consider that weakness in domestic demand is limiting their growth has declined constantly since 2009, while, at the same time, the percentage of entrepreneurs complaining of labour shortages has increased (Graph). We would point out, however, that these numbers are national in scope. The SME owners who complain of shortages of qualified manpower, for example, are mainly those located in Alberta and Saskatchewan (54 % and 53% of respondents, compared with a national average of 38%).■

Limitations on Growth
(February 2009 to August 2014)



Source : Canadian Federation of Independent Business

BUSINESS CREDIT CONDITIONS

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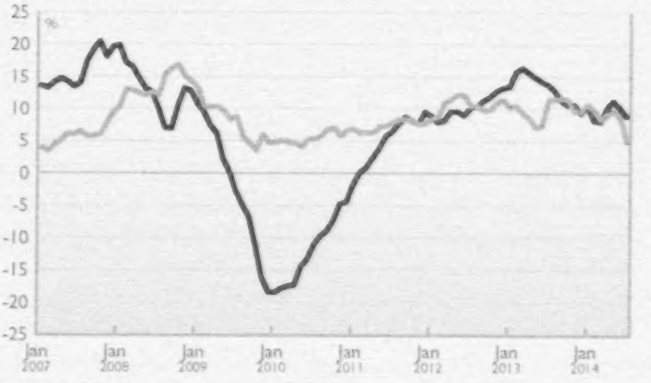
Bank credit granted to businesses declines

In July, the amount of credit granted to businesses by the chartered banks dipped by 0.3% compared with the previous month. This is the second monthly drop in a row. The annual growth in short-term credit (87.5% of total bank credit) fell from 9.9% in June to 8.7% in July, while that of long-term credit fell from 8.5% to 4.7% during the same period (Graph).■

Business Credit from Chartered Banks
(annual change, January 2007 to July 2014)



Source : Statistique Canada

KEY INDICATORS—CANADA

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Key indicators–Canada

	Historical[1]				2014[2]						Forecast	
	2010	2011	2012	2013	Q1	Q2	Q3	Q4	Latest		2014	2015
Real GDP (% growth)	3.4	2.5	1.7	2.0	0.9	3.1			Jun	0.3	2.2	2.5
Machinery and Equipment Expenditures (% growth)	10.6	8.6	5.2	-0.2	-6.6	1.5					0.3	4.9
Pre-Tax Corporate Profits (% growth)	61.6	16.6	-8.2	-0.3	47.8	1.9					7.0	5.1
Industrial Production (% growth)	6.0	3.9	0.9	1.8	4.8	3.5			Jun	0.6	3.8	2.6
Industrial Product Prices (% growth)	1.5	6.9	1.1	0.4	12.7	0.8			Jun	-0.6	2.5	1.8
Non-Residential Construction (% growth)	17.3	12.9	6.9	2.2	-0.7	0.6						
Housing Starts ('000 units)	192	194	215	188	176	196			Jul	200	187	179
Personal Expenditures (% growth)	3.5	2.3	1.9	2.4	1.7	3.8					2.3	2.2
Consumer Price (% growth)	1.8	2.9	1.5	1.0	2.8	3.7			Jul	-0.2	2.0	2.0
Employment (% growth)	1.4	1.5	1.2	1.3	0.4	0.3			Aug	-0.1		
Unemployment Rate (%)	8.0	7.4	7.3	7.1	7.0	7.0			Aug	7.0	7.0	6.7
SMEs Confidence Index (CFIB)	66.7	66.4	63.9	0.0	64.2	65.4			Aug	65.5		
Manufacturers Confidence Index (CFIB)	68.5	67.3	66.7	63.8	64.9	64.6			Aug	71.2		

1. Annual growth rate
2. Quarterly growth, at annual rate
3. Month-over-month growth

Sources: Statistics Canada, Consensus Economics and Canadian Federation of Independent Business.

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START SURVEY DURATION: 5 MINUTES